

REPORT OF
FINANCIAL EXAMINATION

CAPITAL RESERVE LIFE INSURANCE COMPANY

AS OF
JUNE 30, 2005



STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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December 15, 2005
Jefferson City, Missouri

Honorable Alfred W. Gross, Commissioner
Virginia Bureau of Insurance
Chairman, (E) Financial Condition Committee, NAIC

Honorable Jorge Gomez, Commissioner
Wisconsin Department of Insurance
Midwestern Zone Secretary

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Capital Reserve Life Insurance Company

also referred to as "CRL" or as the "Company." The examination was conducted at the Company's home office at 812 Madison Street, Jefferson City, Missouri 65101, telephone number (573) 636-3913. This examination began on August 8, 2005, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Capital Reserve Life Insurance Company was performed as of December 31, 2001. The examination was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) with no other zones participating.

The current full scope association financial examination covers the period from January 1, 2002 through June 30, 2005. It should be noted the examination commenced being as of December 31, 2004; however, it was updated through June 30, 2005, due to significant subsequent events and concerns noted. The examination was conducted by examiners from the State of Missouri representing the Midwestern Zone of the NAIC with no other zones participating.

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditor, Jamie L. Seaver, CPA, LLC of Jefferson City, Missouri, for his statutory audit covering the period from January 1, 2004 through December 31, 2004. This information included, but was not limited to, fraud questionnaires and certain substantive tests relating to account line items.

Comments Previous Examination

Listed below are the comments and recommendations of the previous examination report, dated as of December 31, 2001, and the subsequent response or action taken by the Company.

Comment: Article X of the Company's Bylaws was outdated as it stated that each certificate holder would be levied four assessments each month. It was recommended the Company eliminate this section of Article X or reword it to be consistent with the Company's current products.

Company Response: The Company did not formally respond to the prior examination comments or recommendations.

Current Finding: The Company's Bylaws were revised effective August 2, 2002. All references to assessments were removed from the revised Bylaws.

Comment: The Company's minutes did not reflect some significant corporate events such as the resignation of the former President and the election of his replacement in 1999. The minutes also did not reflect the Board's review of the 1997 MDI Report of Financial Examination. It was recommended the Company properly document the review of significant corporate transactions and events in the Board of Directors' meeting minutes.

Company Response: The Company did not formally respond to the prior examination comments or recommendations.

Current Finding: The Company's minutes for the period January 1, 2002 through December 31, 2004 were reviewed, and it was noted they did not reflect numerous significant corporate events. The Company was unable to provide minutes for meetings held during the period January 1, 2005 through June 30, 2005. See the Corporate Records section of this report for recommendations.

Comment: The State of Missouri Uniform Disposition of Unclaimed Property Act (RSMo 447.500-595) requires all insurance companies report assets presumed abandoned for five years to the Office of the Missouri State Treasurer. It was recommended the Company establish formal escheat procedures to allow for proper identification and submission of abandoned property to the State of Missouri.

Company Response: The Company did not formally respond to the prior examination comments or recommendations.

Current Finding: The Company has established formal escheat procedures.

Comment: The Company stated in a March 15, 2002, Form A filing that "a reassignment of surplus to capital will be made for retirement of all shares not outstanding." It was recommended the Company formulate a plan to redistribute its capital stock to comply with statutory capital stock requirements and submit the plan to the MDI before any redistribution takes place.

Company Response: The Company did not formally respond to the prior examination comments or recommendations.

Current Finding: In September 2002, the Company amended its Articles of Incorporation to reduce the number of authorized shares of common stock from 14,000 to 4,000 and to increase the par value per share from \$50 to \$200.

HISTORY

General

The Company was originally incorporated under the Mutual Assessment laws of Missouri on February 24, 1922, as the Capital Mutual Association. In January 1949, the Company was reincorporated as a Stipulated Premium Life Insurance Company and changed to its current name, Capital Reserve Life Insurance Company.

On December 7, 1955, the Company became a Joint Stock, Legal Reserve Life Insurance Company qualified to do business under the provisions of Sections 376.010 to 376.670 RSMo. In 1971, Peoples National Life Insurance Company was merged into the Company.

Capital Stock

As of June 30, 2005, the Company was authorized to issue 4,000 shares of \$200 par value common stock. There were 3,564 shares issued and outstanding, for a balance of \$712,800 in the Company's common capital stock account.

Dividends

Dividend records prior to 1965 are no longer available. Stockholder dividends paid from 1965 to the present were as follows:

Years	Cash	Stock
1965 - 2001	\$4,012,904	\$500,000
2002	161,010	-0-
2003	107,130	-0-
2004	107,130	-0-
2005	53,460	-0-
Total	4,441,634	\$500,000

The Company has a policy of paying dividends of \$15 per share twice a year. This policy continued throughout the examination period in spite of the Company's continuing losses and declining surplus levels. The prudence of continuing to pay dividends is highly questionable

given the losses incurred by the Company during the examination period. The Company is directed to desist from paying dividends until such time as it returns to a profitable status.

Management

The management of the Company is vested in a Board of Directors elected by the shareholders. Article V of the Company's Articles of Incorporation specify that the Board of Directors shall consist of not less than nine (9) individuals elected at each annual meeting of the shareholders. The directors serving as of June 30, 2005 were as follows:

<u>Name and Address</u>	<u>Business Affiliation</u>
Joseph E. Warden *	President, Chief Executive Officer
Lohman, Missouri	Capital Reserve Life Insurance Company
Jean P. Warden	Chairman of the Board
Holts Summit, Missouri	Capital Reserve Life Insurance Company
Franklin L. Warden	Vice President
Jefferson City, Missouri	Capital Reserve Life Insurance Company
Priscilla Ann Warden	Housewife
Jefferson City, Missouri	
Ethel M. Warden	Housewife
Holts Summit, Missouri	
David H. Warden	Physician
Stillwater, Minnesota	Private Practice
Leanne Warden-Cardwell	Senior Associate for Fiscal Analysis
Jefferson City, Missouri	Missouri Department of Higher Education
Anthony C. Hutchinson	Controller
Eldon, Missouri	Capital Reserve Life Insurance Company
Laura Warden-Smith	Faculty Advisory Nurse
Jefferson City, Missouri	Missouri Department of Health

- * Effective October 6, 2005, Joseph Warden resigned from the Board of Directors. As of the date of this examination report, his replacement had not been elected.

All of the directors with the exception of Tony Hutchinson are related and are also shareholders in the Company. Several of the directors' only qualifications for being appointed to the Board appear to be their family relationships with the other directors. Per Biographical Affidavits filed with the MDI, two of the directors listed their occupation as "housewife" and had no apparent education beyond high school or any prior work experience. Three other directors work in the medical and the accounting fields and appear to have no relevant insurance related experience. The Board of Directors should include individuals who possess both adequate independence and knowledge to fulfill their responsibilities to the Company and, most importantly, to its policyholders. The Company is directed to amend its Articles of Incorporation to include requirements that several of the directors shall be non-shareholders and non-related individuals.

One of the directors, David Warden, did not attend a single Board meeting during the examination period nor was the Company able to provide evidence that he participated in any way in the management of the Company. However, it was noted that he was paid director fees for all of the Board meetings that were held during the examination period. The payment of these fees is in direct conflict with Article III, Section 9, of the Company's Bylaws, which states "...a fixed sum and expenses of attendance, if any, may be allowed for attendance at each regular or special meeting of the Board of Directors." The Company should either remove David Warden as a Director or require his participation in future Board meetings. In addition, all Board fees paid to him should be refunded back to the Company since the fees were not paid for actual attendance at Board meetings as required by the Bylaws.

Article V, Section 1, of the Company's Bylaws stipulate the Board may provide for such committees as it deems necessary. The June 11, 2002, Board of Directors' meeting minutes state that a Compensation Committee consisting of Jean and Frank Warden and an Investment Committee consisting of Joseph and Jean Warden were appointed. However, per discussion with Company personnel, neither of these committees ever met or took any formal actions. Therefore, in effect, the Company had no active committees during the examination period. The Company is directed to either ensure that its committees are taking an active role in managing the Company or to disband the committees.

Article V, Section 1, of the Company's Bylaws states that the officers of the Company shall be a President, one or more Vice-Presidents, a Treasurer, a Secretary and such other officers as may be elected by the Board of Directors. The officers serving as of June 30, 2005 were as follows:

<u>Name</u>	<u>Office Held</u>
Joseph E. Warden *	President
Frank L. Warden	Vice President
Jean P. Warden	Treasurer/Chairman of the Board
Anthony Hutchinson	Secretary

- * Effective September 9, 2005, Joseph Warden resigned as President and was replaced by Jean Warden.

Conflict of Interest

The Company's officers and directors did not complete signed conflict of interest statements for the years 2002 through 2004. Conflict of interest statements were completed in June 2005 by each of the members of the Board of Directors, with the exception of David Warden. The conflict of interest statements completed in 2005 did not fully disclose all potential conflict of interests such as the fact that the Company President, Joseph Warden, also acted as the broker for the Company's investments and one of the directors also served as a director on another Missouri

domestic life insurer. The Company is directed to ensure that all officers and directors complete a conflict of interest statement on an annual basis and that all potential conflicts of interest are properly disclosed on the conflict of interest statements.

Potential conflict of interests, such as Joseph Warden serving as Company President and acting as broker for the Company, in addition to the family relationships between Joseph Warden and the majority of the Company's directors and shareholders, do not appear to have been properly considered by the Board of Directors. As will be documented in other areas of this report, there were serious problems noted in our examination that call into question the competency and performance of Joseph Warden as the Company's President. These concerns include the significant losses incurred by the Company, the poor quality of the Company's investment holdings, and numerous highly-questionable expenses. It appears, partly due to the family relationship between Joseph Warden and the directors, that the Board of Directors failed to properly monitor Joseph Warden's performance as President or timely address concerns once they became aware of them. The Company is directed to ensure the effects to the Company of potential conflicts of interest are fully considered.

Corporate Records

A review was made of the Company's Articles of Incorporation and Bylaws. The Articles of Incorporation were amended May 10, 2002, to change the authorized number of shares of common stock from 14,000 to 4,000 and to increase the par value per share from \$50 to \$200. The Bylaws were revised effective August 2, 2002, to reflect the change in ownership resulting from the withdrawal of the Riley family as part owners and to update various other provisions.

The minutes of the Board of Directors and shareholders' meetings were reviewed for the period under examination. In general, the minutes were vague and did not reflect the major significant corporate events of the Company or that the shareholders/Board of Directors were taking an active role in managing the Company.

Shareholder meeting minutes for 2004 and 2005 were not provided and, it is assumed, did not exist. The last documented election of directors by the shareholders was on March 12, 2002. The Company was unable to provide evidence that four of the directors (David Warden, Anthony Hutchinson, Leanne Cardwell and Laura Smith) serving as of June 30, 2005, were ever formally elected by the shareholders.

Board of Directors' meeting minutes for January through June 2005 were not provided, in spite of repeated requests. It was, therefore, assumed that these also did not exist. The last documented appointment of the Company's officers was March 12, 2002. The Company was unable to provide evidence that two of the officers (Anthony Hutchinson, Secretary and Jean Warden, Treasurer) serving as of June 30, 2005, were ever appointed by the Board. The Company was unable to provide evidence that the aforementioned changes to the Articles of Incorporation and Bylaws were ever approved by the full Board. In addition, the Board of Directors' meeting minutes did not reflect any discussion of the Company's significant losses during the exam period, review or approval of independent CPA audits, review or approval of the prior MDI Report of Financial Examination, discussion or approval of salaries, discussion or approval of various expenses or discussion of various other items which would have indicated the Board was taking an active role in managing the Company.

The Company is directed to ensure that minutes are kept for all shareholders' and Board of Directors' meetings. The minutes should fully document all relevant issues and items discussed and approved. In addition, the Company should ensure that all directors and officers are properly elected or appointed and that significant corporate events are discussed and approved. Such discussions and approvals should be properly reported in the appropriate meeting minutes.

Acquisitions, Mergers and Major Corporate Events

Prior to April 2004, the ownership of the Company was divided equally between two families, the Rileys and the Wardens. By agreement of all shareholders, the ownership of the Company was to remain equally divided between these two families, and each family voted as a block. Therefore, no individual owner had a controlling interest in the Company.

On March 15, 2002, the Company filed a Form A with the MDI stipulating that the Company had reached a preliminary agreement with the Riley family to repurchase 50% of the outstanding common stock. The stock was to be repurchased at a price of \$2,562.60 per share for a total price of \$9,169,000. The Form A filing was approved by the MDI on April 15, 2002, and immediately thereafter the repurchase was effected. The effect of the repurchase was to decrease the total surplus of the Company by the \$9,169,000 amount paid for the stock repurchase.

Surplus Debentures

The Company has not issued any surplus debentures.

AFFILIATED COMPANIES

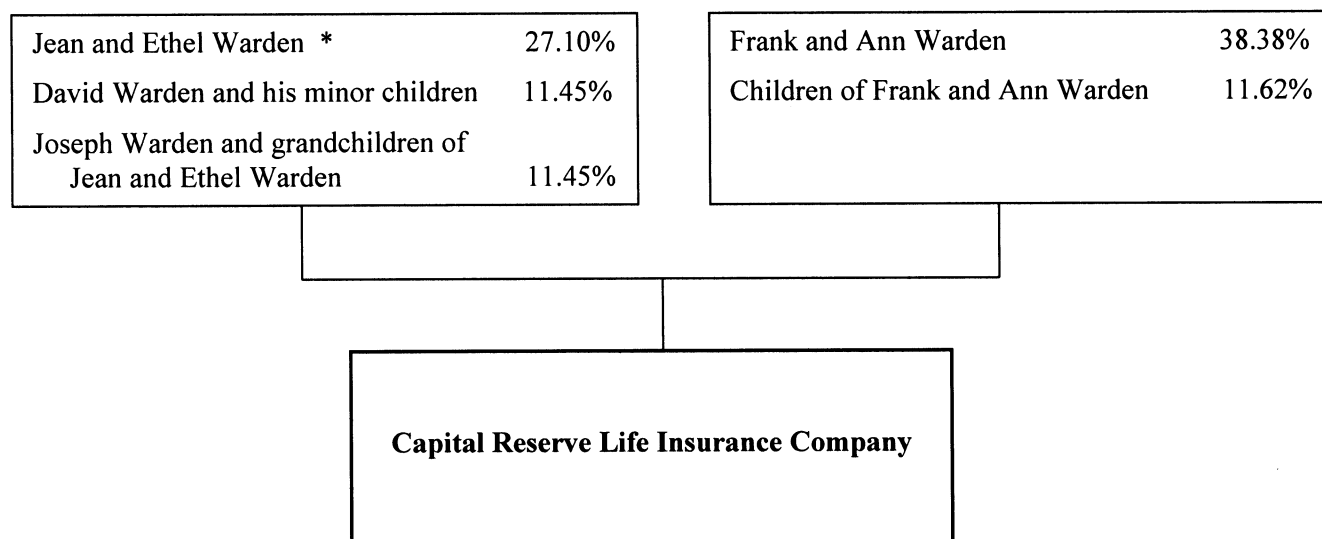
Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010 RSMo (Definitions). The insurance holding company system is composed of the insurance company and three controlling groups of shareholders. Frank and Ann Warden are the ultimate controlling entity, owning 38.38% of the total shares outstanding. Jean and Ethel Warden and David Warden (including stock owned by his minor children) also have a controlling interest as they own over 10% of the outstanding shares.

The Company filed a Form B Insurance Holding Company System Registration Statement for each year under examination.

Organizational Chart

The following organizational chart depicts the holding company system at June 30, 2005.



- * Effective September 14, 2005, the 264 shares of common stock owned by Joseph Warden were transferred to Jean Warden in exchange for forgiveness of a debt owed by Joseph to Jean. Subsequent to this transaction, the percentage ownership for Jean and Ethel Warden increased to 34.51%.

Intercompany Transactions

No entities other than shareholders have been defined as affiliates of the Company. Any transactions between the shareholders and the Company were deemed to be of an immaterial nature and in the normal course of the Company's business with the exception of those items noted in the Accounts and Records section of this report.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on two financial institution bonds. Both of the financial institution bonds individually provide \$200,000 in aggregate coverage for a total of \$400,000 in coverage. There is a \$2,500 deductible on one bond and a \$5,000 deductible on the other bond. This coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Company is also a named insured on various other standard insurance policies. These additional policies include but are not limited to the following:

Directors and Officers Liability	Business Property & Business Personal Property
Workers Compensation	Automobile
Commercial Umbrella	

EMPLOYEE BENEFITS

As of June 30, 2005, CRL had 19 employees. The Company provides its employees with a benefit package that includes group life, accidental death and dismemberment, major medical and dental insurance. Employees may also elect to participate in a 401(k) deferred compensation plan. Under the plan, the Company will match employee contributions up to five percent of the federally imposed maximum contribution amount.

The medical insurance coverage provided by CRL to employees is a through a PPO with Blue Cross Blue Shield of Missouri (Blue Cross). The plan has an annual \$1,000 per member

and \$3,000 per family deductible and a \$20 per office co-payment for visits to providers within the PPO network. If a member receives care from a provider outside the PPO network, the eligible expenses for such services shall be reduced by 20%. However, given that the plan is through Blue Cross, the majority of health care providers within the mid-Missouri region are members of the plan's network. The Company first entered into the PPO agreement with Blue Cross in January of 2001. In addition to the coverage provided by Blue Cross, the Company's ex-President, Joseph Warden, instituted a policy of reimbursing employees for any health care expenses they incurred which were not covered or reimbursed by Blue Cross. This policy was never approved by the Board of Directors, and no formal procedures were ever put into effect regarding the implementation of the policy. It was determined that the medical reimbursement amounts paid to certain individuals during the examination period were extremely excessive and could not be independently confirmed with medical providers. See the Accounts and Records section of this report for comments and recommendations.

The Company also offers employees the option to participate in a cafeteria plan. The cafeteria plan is governed by a written flexible benefits plan established by the Company within the meaning of Section 125 of the Internal Revenue Service Code. Under the written guidelines in the flexible benefit plan, employees are to have an amount withheld from their weekly paycheck and credited to the cafeteria plan. Employees are then to be reimbursed from the cafeteria plan monies for receipts they provide for flexible benefits included in the cafeteria plan such as dependent life insurance, disability insurance, medical insurance deductibles, etc. It was noted during review of the Company's payroll records that each payroll period the Company issues a separate check to employees participating in the cafeteria plan exactly equal to the cafeteria plan withholdings from the employee's regular payroll check. Per discussion with the

Company's Controller, no effort is ever made by the Company to determine any amounts actually paid by employees on approved flexible benefits. Therefore, the cafeteria plan is not being operated in accordance with the written guidelines established by the Company. The Company is directed to immediately desist in withholding cafeteria plan amounts until such time as the Company is able to develop procedures to ensure the cafeteria plan is operated within its own written guidelines. In addition, the Company should consult with its tax advisor to determine whether the cafeteria plan as operated is within the rules and guidelines of the Internal Revenue Service.

Pursuant to an Employment Agreement effective December 1, 1999, Jean Warden was paid a salary of \$90,000 annually for each of the years under examination. His only duties specified in the agreement were: 1) attend and conduct all regular and special meetings of the Board of Directors; 2) serve as consultant on an as-needed basis to the President and CEO; and 3) complete special projects or assignments as assigned by the President. For all practical purposes, Jean Warden was retired after December 1, 1999. The Company was unable to provide evidence that he performed any consulting services or completed any special projects as specified in the Employment Agreement. Therefore, the only services which appear to have been rendered were to act as Chairman of the Board of Directors at the regular Board meetings. The propriety of paying such a substantial annual amount for someone to conduct quarterly meetings is highly questionable especially given the significant losses sustained by the Company and the aforementioned ineffectiveness of the oversight of the Board of Directors.

In addition to the salary amounts paid to Jean Warden, it was also noted that the salaries paid to other members of the Warden family and employees appeared excessive given their assigned responsibilities and work product. For example, Frank Warden, as Vice President, was

paid a total salary of \$130,000 in 2004. However, the majority of his duties were reassigned in April 2004 with the hiring of a new Information Systems Director. Linda Warden was paid \$25,000 in 2004 as the Manager of Marketing; however, the Company was unable to provide evidence of any service that she actually provided to the Company. The Company is directed to perform an evaluation of the salaries paid to all employees and develop written job duties and descriptions for all employees. For those salaries which are determined to be excessive, the Company is directed to assign sufficient duties to these employees to justify the salary amounts paid or reduce their salary amounts accordingly.

During the examination period, the Company paid \$115,000 in bonuses to employees, including \$60,000 paid to members of the Warden family. The Employment Agreement with Jean Warden states that the Company will match his reasonable contribution to the University of Missouri. This annual contribution amount was limited to \$3,500 by the Board of Directors at their January 8, 2002 meeting. It was noted that a bonus of \$10,000 was paid to Jean Warden in both 2003 and 2004. Other than the agreement with Jean Warden, there is no written policy regarding employee bonuses. None of the bonuses were approved by the Board of Directors nor was there any type of written bonus plan that would have tied the amounts paid to performance or profitability. Given the losses sustained by CRL, the paying of bonuses to employees appears to be highly questionable. Therefore, the Company is directed to desist from paying any employee bonuses until it has returned to a profitable status. Also, the Company should ensure any bonuses are part of a written bonus plan tied to employee and/or Company performance and approved by the Board of Directors.

CRL provides vehicles to seven employees and also provides credit cards for these employees to purchase fuel for the CRL owned vehicles. Five of the vehicles are assigned to

individuals working in the Company's sales staff. One of the other vehicles was assigned to the Company President, Joseph Warden, and the other is assigned to the Company Vice-President, Frank Warden. The Company was unable to provide any legitimate business purpose for assigning vehicles to either Joseph or Frank Warden. Furthermore, it appears that under Internal Revenue Service rules and guidelines, any personal use of an employer provided vehicle should be considered taxable income and included in the amount reported on the employee W-2 forms. Although the Company has written procedures requiring the tracking of personal usage of vehicles for tax purposes, the Company failed to maintain records of personal usage, and therefore, did not include any such usage in the amounts reported on the employee W-2 forms. The Company is directed to evaluate its policy of providing vehicles to employees. Vehicles should only be provided to employees for whom there is a legitimate business purpose for that employee to need a Company provided vehicle. The Company is also directed to ensure its procedures requiring the tracking of personal usage of vehicles are enforced and to consult with its tax advisor to determine any amounts which should have been reported to the IRS.

In addition to the personal use of employer provided vehicles, it was also noted that the Company failed to include other wage and fringe benefit amounts that may be taxable in amounts reported on employee W-2 forms. These amounts included quarterly meeting fees paid to directors, tuition reimbursements, amounts withheld under the aforementioned cafeteria plan and the aforementioned medical reimbursements. The Company should consult with its tax advisor to determine the tax status of these items and file amended W-2 forms for prior years if determined to be necessary. In addition, the Company should develop procedures to ensure all taxable wages and fringe benefits are properly accounted for and reported.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of June 30, 2005, as reflected below, were sufficient to meet the trust deposit requirements for the State of Missouri as defined in Section 376.290 RSMo (Trust Deposits).

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
U.S. T-Note	\$650,000	\$640,965	\$643,369

Deposits with Other States

The Company does not maintain deposits in any other states.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Company is licensed with the Missouri Department of Insurance under Chapter 376 RSMo for life and accident and health insurance. The Company is also licensed in Iowa and Kansas. For the six month period ending June 30, 2005, 85.65 percent of the Company's direct premiums and annuity considerations were from the State of Missouri and 14.27 percent were from the State of Kansas.

The Company offers a variety of ordinary life insurance products and annuity products to insureds. The Company's agent force consists primarily of funeral home directors who market the Company's products in order to fund pre-planned funeral agreements.

During the examination period, the Company experienced a substantial growth in premium volume due mainly to increased sales of its annuity products. However, due to the high reserve requirement of these products, the increase in premium volume did not translate into increased profitability. Significant losses and declines in capital and surplus were noted for each of the years in the examination period as follows:

<u>Year</u>	<u>Net Loss Incurred</u>	<u>Ending Capital and Surplus</u>
2002	\$(232,254)	\$6,605,994
2003	(505,290)	6,003,509
2004	(1,173,550)	4,598,927
2005 (as of June 30)	(520,554)	3,668,245

In spite of the significant losses being incurred, the Company did not have a written business plan or marketing plan in place documenting how management intended to return the Company to a profitable status. It was also noted the Company did not prepare budgets or forecasts. There was no evidence the Board of Directors had requested any such information from management nor was there any discussion noted in the Board of Directors' meeting minutes concerning the losses or declines in surplus.

Per the request of the MDI, the Company began the preparation of a business plan for 2006. The Company is directed to complete a comprehensive three year business plan and submit it to the MDI for review. In addition, the Company is directed to prepare budgets and forecasts and to prepare variance reports showing the differences between budgeted and actual amounts to assist in monitoring the Company's on-going financial condition. These reports should be reviewed and approved at each of the quarterly Board of Directors' meetings with the Board taking a more active role in monitoring and directing the Company.

Policy Forms, Underwriting, Advertising & Treatment of Policyholders

The Missouri Department of Insurance has a market conduct staff that performs a review of these issues and generates a separate market conduct report. The last Market Conduct examination was conducted in 1974. This examination performed a cursory review of various market conduct areas and no material problems were noted.

REINSURANCE

General

The Company's reinsurance and premium activity on a direct written, assumed and ceded basis for the period under examination is detailed below:

	2005 (as of June 30)	2004	2003	2002
<u>Premiums</u>				
Direct premiums written	\$ 823,864	\$ 5,810,925	\$ 2,730,523	\$ 1,203,356
Reinsurance assumed	-	83,516	65,757	55,348
Reinsurance ceded	1,653	4,787	6,857	9,040
Net premiums written	<u>\$ 822,211</u>	<u>\$ 5,889,654</u>	<u>\$ 2,789,423</u>	<u>\$ 1,249,664</u>

Assumed

The Company is an assuming reinsurance participant in a group life policy issued by the Prudential Insurance Company of America (Prudential) on the lives of servicemen, identified as "Servicemen's Group Life Insurance" (SSGLI). This insurance is administered by Prudential and ceded to the participating companies. Capital Reserve's share of this pool as of December 31, 2004 was 0.00921 percent. The Company percentage participation as of June 30, 2005, could not be determined as the Company terminated its participation in the pool effective July 1, 2005.

Ceded

The Company is contingently liable for all reinsurance losses ceded or retroceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the agreement.

Effective May 1, 1996, CRL entered into agreements with Business Men's Assurance Company of America (BMA). These agreements provide reinsurance for individual life insurance, joint decreasing term and accidental death benefits. The Company's net retention on any one life is \$25,000. The Company cedes 100% of accidental death liability to BMA. In 2002, CRL was notified that Generali USA Life Reassurance Company (Generali) assumed all of BMA's reinsurance contracts under an assumptive reinsurance agreement and that new reinsurance agreements reflecting the change in reinsurer would be forthcoming. The new contracts were never issued and on June 30, 2005, the Company was notified by Generali that the reinsurance agreements had been assigned to Optimum Re Insurance Company (Optimum Re). Optimum Re was to contact the Company regarding new reinsurance agreements to reflect the latest change in reinsurers. As of the date of this examination report, the Company still had not obtained updated reinsurance agreements with Optimum Re.

ACCOUNTS AND RECORDS**Independent Auditor and Actuary**

The statutory audits for each of the years under examination were performed by Jamie L. Seaver, CPA, LLC of Jefferson City, Missouri.

The actuarial items reported by the Company as of December 31, 2004, were certified by Terry M. Long FSA, MAAA, of Lewis & Ellis, Inc. of Overland Park, KS. The actuarial items reported by the Company as of December 31, 2003 and December 31, 2002, were certified by George Davidson III, FCSA, MAAA, who was an employee of the Company.

Reimbursement Payments to Joseph and Linda Warden

As indicated in the Employee Benefits section of this report, in 2001, the then-President of the Company initiated a policy of reimbursing employees for medical and dental expenses that were not covered by the Company provided health and dental plans. This policy was not approved by the Board of Directors nor were formal procedures established for implementing this policy.

In 2004, reimbursements paid to Linda and Joseph Warden for medical care they allegedly received from Boone Hospital Center (BHC) totaled \$156,283. In the period January 1, 2005 through August 11, 2005, medical reimbursements paid to Joseph and Linda Warden for medical care allegedly provided by BHC totaled \$327,658. The Missouri Department of Insurance contacted BHC in order to independently confirm any medical services provided by BHC to Joseph and Linda Warden during the time periods in question. The confirmation returned by BHC indicated that BHC was unable find any information in their billing system that fully corresponded to the amounts claimed by either Joseph or Linda Warden.

In addition to the reimbursements for medical services allegedly provided by BHC, dental care reimbursements totaling \$41,348 and \$45,887 were made in 2003 and 2004 respectively to Joseph and Linda Warden for dental care they allegedly received from a dentist in Colorado. A review of non-medical and non-dental related reimbursements made to Joseph and Linda Warden for the period January 1, 2004 through June 30, 2005 was performed and

numerous problems were noted. A total of \$10,647 was found to have been overpaid due to items being submitted more than once for reimbursement. A total of \$22,473 was found to have been overpaid due to supporting documentation not agreeing to the total reimbursed. Specifically, reimbursement was made for jewelry, books, paintings and other personal items which had no apparent business purpose and in other instances the supporting documentation was incomplete making it impossible to determine the exact purpose of the reimbursement.

Subsequent to the examination date, per a request of the MDI, the Company halted all reimbursement payments to Joseph and Linda Warden. Effective September 12, 2005, Joseph Warden resigned as Company President and Linda Warden was terminated as Marketing Manager. See the Subsequent Events section of this report for further details. The Company should take immediate action to attempt to recover the over \$600,000 in questionable reimbursements made to Joseph and Linda Warden. In addition, the Company should thoroughly review all other payments made directly or indirectly to Joseph and Linda Warden to determine any additional questionable amounts that should be paid back to the Company.

Fraud and Abuse Policy/Code of Ethics

The Company does not have either a written code of ethics or a written fraud and abuse policy. Numerous internal control problems were noted during the review of the reimbursements made to employees. Although the Company had some internal controls in place relating to approval of employee reimbursements, the individual employees responsible for ensuring these procedures were enforced failed to question any of the reimbursement documentation submitted by Joseph or Linda Warden. In addition, a review of medical reimbursements paid to these same employees noted similar problems as were noted in review of the medical reimbursements made to Joseph and Linda Warden. For example, it was noted the employee directly responsible

for approving medical reimbursements was reimbursed three times in a four month period for the same medical service provided.

Based on discussions between these employees and the examination team, it was clear the employees were fully aware of the highly questionable nature of the reimbursements made to Joseph and Linda Warden. However, no effort was made to inform the Board of Directors, the Missouri Department of Insurance or the independent auditor regarding the reimbursements until such time as it was clear that their validity would be or had been questioned by the independent auditor or as part of the MDI examination.

Company management should ensure that internal controls are properly defined, implemented and enforced. Employees who have shown an unwillingness or incapacity to enforce internal controls in the past should be removed from such duties or terminated. In addition, the Company is directed to develop a written code of ethics/fraud and abuse policy, ensure it is communicated to employees and ensure employees are properly trained regarding the policy's implementation. The policy should clearly indicate what constitutes fraud and abuse, how potential fraud and abuse is to be reported, to whom it should be reported and the consequences of any failure to timely report suspected fraud or abuse. Employees who have failed in the past to meet the code of ethics/fraud and abuse policy or who fail to do so in future should be dealt with accordingly.

Management Competence

In addition to the deficiencies noted above and in previous other sections of this report, several other concerns were noted in relation to competency of the Company's management and senior accounting personnel. Numerous errors, some of which are documented in the Notes to the Financial Statements section of this report, were noted on the June 30, 2005 Quarterly

Statement. These errors appeared to partially be due to the lack of insurance expertise of the Company's Controller and other accounting personnel. It was noted that the Controller had no experience in the insurance field prior to his coming to work for the Company in 2001. It does not appear he has obtained sufficient training or guidance during his employment which would enable him to develop the thorough understanding of insurance accounting, Missouri statutes and regulations or Statements of Statutory Accounting Principles (SSAPs) necessary to adequately perform the Company's accounting functions or complete the Company's Annual and Quarterly Statement filings. The Company should ensure that management and accounting personnel possess the necessary insurance expertise to perform their job functions.

Broker's Agreements

The Company's President, Joseph Warden, also served as the broker for the Company's investments and hence received commissions for investment activity. The Company was unable to provide a written broker's agreement between itself and Joseph Warden for the provision of these services. In addition, there was no evidence that the appointment of Joseph Warden as the Company's investment broker was approved by the Board of Directors. Subsequent to the examination date, Joseph Warden was removed as investment broker and a new investment broker was obtained by the Company. The Company is directed to ensure that all significant agreements are in writing and are approved by the Board of Directors.

Securities Ratings

The Company does not have any written investment guidelines. In review of the Company's investment portfolio as of June 30, 2005, it was noted the Company reported 12.72 percent of its investments in bonds to be in medium to lower grade bonds. However, the ratings assigned by the Company to its bonds were as of the bond purchase dates and did not reflect

subsequent downgrades. By adjusting the bond ratings to reflect subsequent downgrades, it was determined that the actual amount of the Company's bond investments in medium to lower grade bonds was 46.5 percent. This investment in medium to lower grade bonds accounted for 41.24 percent of the Company's total admitted assets as of June 30, 2005. The Company is referred to Section 375.1075 RSMo (Limitations on aggregate of medium or lower quality investments, requirements) which sets limits on the amounts an insurer can invest in medium to lower grade investments and requires an insurer to non-admit any portion of additional investments purchased that exceed these limits. As the Company's holdings in medium to lower grade bonds already exceed the established limits, the full amount of any additional medium to lower grade securities purchased will have to be non-admitted. The Company is directed to develop written investment guidelines which are in compliance with the investment limitations imposed by Missouri statutes and regulations. In addition, the Company is directed to ensure that ratings of securities are properly updated to reflect security downgrades.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of June 30, 2005, and the results of operations for the fiscal period then ended. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the financial statements.

There may have been additional differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial in relation to the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual financial statement item.

ASSETS

Bonds (Note 1)	\$ 17,657,496		\$ 17,657,496
Preferred stocks	99,301		99,301
Common stocks	201,354		201,354
Real estate (Note 2)	467,594	\$ 180,611	286,983
Policy loans	161,026		161,026
Cash and short term investments (Note 3)	1,410,178		1,410,178
Investment income due and accrued	329,850		329,850
Premiums deferred and uncollected	246,202		246,202
Net deferred tax asset (Note 4)	-		-
Guaranty funds receivable	540		540
EDP equipment (Note 5)	121,252	77,550	43,702
Furniture and equipment	161,359	161,359	-
Prepaid expenses	10,406	10,406	-
	<hr/>	<hr/>	<hr/>
Total Assets	\$ 20,866,558	\$ 429,926	\$ 20,436,632
	<hr/>	<hr/>	<hr/>

LIABILITIES SURPLUS AND OTHER FUNDS

Aggregate reserve for life policies (Note 6)	\$ 16,108,027
Liability for deposit-type contracts	15,996
Policy and contract claims	91,659
Premiums received in advance	17,240
Interest maintenance reserve (Note 7)	176,212
General expenses due or accrued	3,536
Federal and foreign income taxes	30,000
Unearned investment income	4,031
Asset valuation reserve (Note 8)	254,532
Dividends to stockholders declared and unpaid (Note 9)	53,460
Premium suspense	12,796
Premium over and short	<u>898</u>
Total liabilities	\$ 16,768,387
Common capital stock	\$ 712,800
Unassigned funds (surplus)	<u>2,955,445</u>
Total Capital and Surplus	\$ <u>3,668,245</u>
Total Liabilities and Capital and Surplus	\$ <u><u>20,436,632</u></u>

SUMMARY OF OPERATIONS

Premium considerations	\$ 2,250,419	
Net investment income	579,110	
Amortization of Interest Maintenance Reserve	407	
Miscellaneous income	2,516	
Death benefits	(406,928)	
Matured endowments	(17,865)	
Annuity benefits	(325,606)	
Surrender benefits and withdrawals for life contracts	(80,992)	
Increase in aggregate reserves	(1,301,557)	
Commissions on premiums	(125,442)	
General insurance expenses	(1,203,319)	
Insurance taxes, licenses and fees	<u>(32,196)</u>	
Gain from operations before federal income taxes and realized capital gains or (losses)		\$ (661,453)
Federal income taxes incurred		-
Net realized capital gains or (losses)		<u>140,899</u>
Net Income		<u>\$ (520,554)</u>

CAPITAL AND SURPLUS ACCOUNT

Net Income	(520,554)	
Change in net unrealized capital gains (losses)	64,981	
Change in nonadmitted assets	10,669	
Change in asset valuation reserve	20,179	
Examination changes	<u>(505,957)</u>	
Change in surplus as regards policyholders		<u>(930,682)</u>
Surplus as regards policyholders, June 30, 2005		<u>\$ 3,668,245</u>

NOTES TO FINANCIAL STATEMENTS

Note 1: Bonds

\$ 17,181,134

The amount reported under bonds was reduced by \$1,000,000 to reclassify bonds and certificates of deposit that had been purchased with maturity dates within in one year of purchase to cash and short-term investments. Per SSAP No. 2 (Cash, Drafts, and Short-term Investments), certificates of deposit purchased within one year or less of their maturity date should be classified as cash, and bonds purchased within one year or less of their maturity date should be classified as short-term investments. The Company should ensure that it correctly classifies items on future statement filings.

Note 2: Real estate

\$286,983

This asset account was decreased by \$180,611. In January 1998, the Company purchased a house adjacent to its home office for \$26,701 and paid \$16,839 in demolition costs to have the house demolished and removed from the property. The entire \$16,839 in demolition costs has been non-admitted in accordance with SSAP No. 40 (Real Estate Investments) since the costs appear to be non-recoverable. In October 2000, the Company purchased a second home also adjacent to its home office for a total cost of \$56,139. The Company subsequently remodeled the house, and as of June 30, 2005, reported a total value of \$362,058 for the property including the remodeling costs. A total amount of \$163,772 of the reported value of this property has been non-admitted due to the following:

- The Company was unable to provide invoices or other supporting documentation for \$85,766 of the remodeling costs reported. Therefore, as these costs could not be substantiated, this amount was disallowed.
- A total of \$56,139 of the remodeling costs related to items which under SSAP No. 40, did not qualify as capital expenditures, and therefore, should have been expensed rather than capitalized.

- An adjustment of \$21,867 was made to the accumulated depreciation on the property due to the fact that the Company calculated depreciation for the property and remodeling as of August 1, 2003, rather than the actual service date in accordance with SSAP No. 40.

The Company is directed to ensure that real estate values only include costs which the Company can substantiate and only items which qualify as capital expenditures. In addition, the Company should ensure that the depreciation on real estate is properly calculated in accordance with SSAP No. 40.

Note 3: Cash and short-term investments **\$1,410,178**

This asset account was increased by \$1,000,000 to reclassify the bonds and certificates of deposits purchased having a maturity date within one year or less of the purchase date in accordance with SSAP No. 2 as described in **Note 1**.

Note 4: **Deferred tax asset** **\$-0-**

The deferred tax asset of \$18,700 was completely disallowed as the Company was unable to provide any documentation as to how the amount reported had been determined. The Company is referred to SSAP No. 10 (Income Taxes) which provides guidance for the determination and reporting of deferred taxes. The Company should ensure that deferred taxes are properly calculated and reported on future filings.

Note 5:	EDP equipment	\$43,702
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This asset account has been decreased by \$76,286 to non-admit non-operating software. Per SSAP No. 16 (EDP Equipment and Software), Paragraph (2), only EDP equipment and operating software are allowable as admitted assets. Non-operating software is to be non-admitted. The Company is directed to ensure that it properly non-admits non-operating software from future Statement filings.

Note 6:	Aggregate reserves for life contracts	\$16,108,027
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This liability account was increased by \$29,135 to account for the supplemental benefits reserve. The amount of this component of the reserves is calculated by the Company's claims system. However, the Company's Controller failed to include the June 30, 2005, amount for this reserve in the total aggregate reserve amount reported. The Company should ensure that all components of its reserves are properly included and reported in its aggregate reserves amounts.

Note 7:	Interest maintenance reserve	\$176,212
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This liability account has been increased by \$74,841 to adjust for the factoring of the current year's realized pre-tax capital gains into the interest maintenance reserve calculation. The Company's Controller initially failed to input the realized capital gains into the Company's investment software system because he did not realize that it was necessary to manually enter these amounts. Therefore, the realized capital gains were not reflected in the amount reported on the June 30, 2005 Quarterly Statement. The Company should ensure that the interest maintenance reserve is properly calculated and reported for future filings.

Note 8:	Asset valuation reserve	\$254,532
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This liability account was increased by \$72,924. The Company was unable to produce a report from its investment software system to support the initial amount reported on the June 30, 2005 Quarterly Statement. Per the Company Controller, the amount initially reported was incorrect due to errors he made in inputting information into the investment software system. A subsequent “corrected” report generated by the Controller after adjusting for these errors indicated a balance \$10,498 higher than initially reported. In reviewing the “corrected” report, it was noted that bonds were not properly classified on the supporting worksheets, realized capital gains on common stock were not properly included, and real estate had not been adjusted to

reflect changes in real estate values as a result of our examination. An additional adjustment of \$62,426 was made to account for these items. The Company should ensure that the asset valuation reserve is properly calculated and reported for future filings.

Note 9:	Dividends to stockholders declared and unpaid	\$53,460
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A liability was established for dividends to stockholders declared as of June 30, 2005, but not paid until July 1, 2005. The Company's policy is to declare dividends at its June and December Board of Directors' meetings. Although the Company was unable to provide minutes of the June 2005 Board meeting, it was noted that dividends were paid to shareholders on July 1, 2005. Therefore, it is assumed that the dividends were declared at the June 2005 meeting, and a liability was established in an amount equal to the July 1, 2005 dividend payments.

EXAMINATION CHANGES**Capital and surplus per company:**

Common capital stock	\$ 712,800	
Unassigned funds (surplus)	<u>3,461,402</u>	
Total capital and surplus		\$ 4,174,202

	<u>Increase In Surplus</u>	<u>Decrease In Surplus</u>	
Assets			
Bonds (Note 1)		\$ (1,000,000)	
Real estate (Note 2)		(180,611)	
Cash and short-term investments (Note 3)	\$ 1,000,000		
Deferred tax asset (Note 4)		(18,700)	
EDP equipment (Note 5)		(76,286)	
Liabilities			
Aggregate reserve for life policies (Note 6)		(29,135)	
Interest maintenance reserve (Note 7)		(74,841)	
Asset valuation reserve (Note 8)		(72,924)	
Dividends to stockholders declared but unpaid (Note 9)		<u>(53,460)</u>	
Net Change			<u>(505,957)</u>

Capital and surplus per examination:

Common capital stock	\$ 712,800	
Unassigned funds (surplus)	2,955,445	
		<u>\$ 3,668,245</u>

GENERAL COMMENTS AND/OR RECOMMENDATIONS**Dividends****Page 4**

The Company has a policy of paying dividends of \$15 per share twice a year. This policy continued throughout the examination period in spite of the Company's continuing losses and declining surplus levels. The prudence of continuing to pay dividends is highly questionable given the losses incurred by the Company during the examination period. The Company is directed to desist from paying dividends until such time as it returns to a profitable status.

Management**Page 5**

The Board of Directors should include individuals who possess both adequate independence and knowledge to fulfill their responsibilities to the Company and, most importantly, to its policyholders. The Company is directed to amend its Articles of Incorporation to include requirements that several of the directors be non-shareholders and non-related individuals.

One of the directors, David Warden, did not attend a single Board of Directors' meeting during the examination period. However, he was paid director fees for each of the meetings held during the examination period. The payment of these fees is in direct conflict with Company's Bylaws, which state fees are only allowed for attendance at each regular or special meeting of the Board of Directors. The Company should either remove David Warden as a director or require his participation in future Board meetings. In addition, all Board fees that have been paid to him should be refunded back to the Company since these fees were not paid for actual attendance as required by the Bylaws.

The June 11, 2002, Board of Directors' meeting minutes state that a Compensation Committee consisting of Jean and Frank Warden and an Investment Committee consisting of Joseph and Jean Warden were appointed. Per discussion with Company personnel, neither of these committees ever met or took any formal actions. Therefore, in effect, the Company had no active committees during the examination period. The Company is directed to either ensure that its committees are taking an active role in managing the Company or to disband the committees.

Conflict of Interest**Page 7**

Conflict of interest statements were not completed for any of the years under examination with the exception of 2005. In addition, the conflict of interest statements completed in 2005 did not fully disclose all potential conflicts of interest. The Company is directed to ensure that all officers and directors complete a conflict of interest statement on an annual basis and that all potential conflict of interest are properly disclosed.

Potential conflicts of interest such as Joseph Warden serving as Company President and also acting as broker for the Company in addition to the family relationships between Joseph Warden and the majority of the Company's directors and shareholders, do not appear to have been properly considered. There were serious problems noted in our examination that call in to question the competency and performance of Joseph Warden as the Company's President. It appears, partly due to the family relationship between Joseph Warden and the directors, that the Board of Directors failed to properly monitor Joseph Warden's performance as President or timely address concerns once they became aware of them. The Company is directed to ensure the effects to the Company of potential conflicts of interest are fully considered.

Corporate Records**Page 8**

The Company was unable to provide minutes for Board of Directors' meetings and shareholder meetings held in the first half of 2005. In review of the meeting minutes provided for the other years under examination, it was noted that the minutes did not contain documentation of significant corporate events such as the election of directors, appointment of officers, approval of changes to the Articles of Incorporation and Bylaws, discussion of operating results and various other items. The Company is directed to ensure that minutes are kept for all shareholder and Board of Director meetings. In addition, the Company should ensure that all directors and officers are properly elected or appointed and that significant corporate events are discussed and approved. Such discussions and approvals should be properly reported in the appropriate meeting minutes.

Employee Benefits**Page 12**

The Company issued a separate check to employees participating in the employee cafeteria plan exactly equal to the cafeteria plan withholdings from the employee's regular payroll check. Per discussion with the Company's Controller, no effort was made by the Company to determine any amounts actually paid by employees on approved flexible benefits under the cafeteria plan. Therefore, the Company's cafeteria plan was not being operated in accordance with the written guidelines for the plan established by the Company. The Company is directed to immediately desist in withholding cafeteria plan amounts until such time as the Company is able to develop procedures to ensure the plan is operated within its own written guidelines. In addition, the Company should consult with its tax advisor to determine whether the cafeteria plan as operated is within the rules and guidelines of the Internal Revenue Service.

The salary amounts paid by the Company to various members of the Warden family and employees appeared excessive given their assigned job duties and work product. The Company is directed to perform an evaluation of the salaries paid to all employees, and develop written job duties and descriptions for all employees. For those salaries which are determined to be excessive, the Company is directed to assign sufficient duties to these employees to justify the salary amounts paid or reduce the salary amounts accordingly.

During the examination period, the Company paid \$115,000 in bonuses to employees, including \$60,000 paid to members of the Warden family. None of the bonuses were approved by the Board of Directors nor was there any type of written bonus plan that would have tied the amounts paid to performance or profitability. Given the losses sustained by the Company, the paying of bonuses to employees appears to be highly questionable. The Company is directed to desist from paying any employee bonuses until the Company has returned to a profitable status. Also, the Company should ensure that any bonuses are part of a written bonus plan tied to employee and/or Company performance and approved by the Board of Directors.

The Company was unable to provide any legitimate business purpose for assigning vehicles to either Joseph or Frank Warden. Furthermore, the Company failed to follow its own written procedures requiring the tracking of personal usage of vehicles for tax purposes, and therefore, failed to include any such usage in the amounts reported on employee W-2 forms. The Company is directed to evaluate its policy of providing vehicles to employees. Vehicles should only be provided to employees for whom there is a legitimate business purpose for that employee to need a Company provided vehicle. The Company is also directed to ensure its procedures requiring the tracking of personal usage of vehicles are enforced and to consult with its tax advisor to determine any amounts which should have been reported to the IRS.

In addition to the personal use of employer provided vehicles, it was also noted that the Company failed to include other wage and fringe benefit amounts that may be taxable in amounts reported on employee W-2 forms. These amounts included quarterly meeting fees paid to directors, tuition reimbursements, amounts withheld under the cafeteria plan and medical reimbursements. The Company should consult with its tax advisor to determine the tax status of these items and file amended W-2 forms for prior years if determined to be necessary. In addition, the Company should develop procedures to ensure all taxable wages and fringe benefits are properly accounted for and reported.

Territory and Plan of Operations**Page 17**

In spite of significant losses being incurred, the Company did not have a written business plan or marketing plan in place documenting how management intended to return the Company to a profitable status. It was also noted the Company did not prepare budgets or forecasts. There was no evidence the Board of Directors had requested any such information from management nor was there any discussion noted in the Board of Directors' meeting minutes concerning the losses or declines in surplus. The Company is directed to complete a comprehensive three year business plan and submit it to the MDI for review. In addition, the Company is directed to prepare budgets and forecasts and to prepare variance reports showing the differences between budgeted and actual amounts to assist in monitoring the Company's on going financial condition. These reports should be reviewed and approved at each of the quarterly Board of Directors' meetings with the Board taking a more active role in monitoring and directing the Company.

Reimbursement Payments to Joseph and Linda Warden**Page 21**

Medical reimbursements made to Joseph and Linda Warden in the amount of \$156,283 and \$327,658 in 2004 and 2005 respectively could not be independently substantiated. In addition, dental reimbursements totaling \$41,348 and \$45,887 were made to Joseph and Linda Warden in 2003 and 2004 respectively. A review of non-medical reimbursements made to Joseph and Linda Warden during the period January 1, 2004 through June 30, 2005 noted \$10,647 was overpaid due to the same item being reimbursed more than once and another \$22,437 was overpaid due to various other reasons. The Company should take immediate action to recover the over \$600,000 in questionable reimbursements made to Joseph and Linda Warden. In addition, the Company should thoroughly review all other payments made directly or indirectly to Joseph and Linda Warden to determine any additional questionable amounts.

Fraud and Abuse Policy/Code of Ethics**Page 22**

The Company does not have a written code of ethics or written fraud and abuse policy. Although the Company had some internal controls in place relating to approval of expenses and reimbursements, the individual employees responsible for ensuring these procedures were enforced failed to question any of the reimbursement documentation submitted by Joseph or Linda Warden. In addition, questionable items were also noted in some of the medical reimbursements paid to these employees. The employees failed to report the questionable nature of the reimbursements made to Joseph and Linda Warden to the Board of Directors, the Missouri Department of Insurance or the independent auditor until such time as it was clear that their validity would be or had been questioned by the independent auditor or as part of the MDI examination. Company management should ensure that internal controls are properly defined, implemented and enforced. Employees who have shown an unwillingness or incapacity to

enforce internal controls in the past should be removed from such duties or terminated. In addition, the Company is directed to develop a written code of ethics/fraud and abuse policy, ensure it is communicated to employees and ensure employees are trained regarding the policy's implementation. The policy should clearly indicate what constitutes fraud and abuse, how potential fraud and abuse is to be reported, to whom it should be reported and consequences of any failure to timely report suspected fraud or abuse. Employees who have failed in the past to meet the code of ethics/fraud and abuse policy or who fail to do so in the future should be dealt with accordingly.

Management Competence

Page 24

Various concerns were noted in relation to competency of the Company's management and senior accounting personnel. Numerous errors, some of which were documented in the Notes to the Financial Statements section of this report, were noted on the June 30, 2005 Quarterly Statement. These errors appeared to partially be due to the lack of insurance expertise of the Company's Controller and other accounting personnel. It was noted that the Controller had no experience in the insurance field prior to his coming to work for the Company in 2001. It does not appear he has obtained sufficient training or guidance during his employment which would enable him to develop the thorough understanding of insurance accounting, Missouri statutes and regulations or Statements of Statutory Accounting Principles necessary to adequately perform the Company's accounting functions or complete the Company's Annual and Quarterly Statement filings. The Company should ensure that management and accounting personnel possess the necessary insurance expertise to perform their job functions.

Broker's Agreements**Page 24**

The Company was unable to provide a written broker's agreement between itself and its ex-President, Joseph Warden. In addition, there was no evidence that the appointment of Joseph Warden as the investment broker was approved by the Board of Directors. The Company is directed to ensure that all significant agreements are in writing and are approved by the Board of Directors.

Securities Ratings**Page 25**

The Company does not have any written investment guidelines. The ratings as of June 30, 2005, assigned by the Company to its bonds were as of bond purchase dates and did not reflect subsequent downgrades. By adjusting the bond ratings to reflect subsequent downgrades, it was determined that the amount of the Company's investment in medium to lower grade bonds accounted for 41.24 percent of the Company's total admitted assets as of June 30, 2005. The Company is referred to Section 375.1075 RSMo that limits the amounts an insurer can invest in medium to lower grade investments and requires an insurer to non-admit any portion of additional investments purchased that exceed these limits. As the Company's holdings in medium to lower grade bonds already exceed the limits in Section 375.1075, the full amount of any additional medium to lower grade securities will have to be non-admitted. The Company is directed to develop written investment guidelines which are in compliance with the investment limitations imposed by Missouri statutes and regulations. In addition, the Company is directed to ensure security ratings are properly updated to reflect subsequent downgrades.

Bonds**Page 30**

The investment in bonds amount reported was decreased by \$1,000,000 to reclassify bonds and certificates of deposit that had been purchased with maturity dates within in one year of purchase to cash and short-term investments. Per SSAP No. 2 (Cash, Drafts, and Short-term Investments), certificates of deposit purchased within one year or less of their maturity date should be classified as cash, and bonds purchased within one year or less of their maturity date should be classified as short-term investments. The Company should ensure that it correctly classifies items on future statement filings.

Real Estate**Page 30**

The amount the Company reported as real estate holdings was decreased by \$180,611 in order to non-admit demolition costs which were deemed to be non-recoverable, to disallow remodeling costs the Company was unable to substantiate, disallow remodeling costs related to items which under SSAP No. 40 did not qualify as capital expenditures and adjust the accumulated depreciation to properly calculate depreciation based on service dates. The Company is directed to ensure that real estate values only include costs which the Company can substantiate and only items which qualify as capital expenditures. In addition, the Company should ensure that the depreciation on real estate is properly calculated in accordance with SSAP No. 40.

Deferred tax asset**Page 31**

The deferred tax asset of \$18,700 was completely disallowed as the Company was unable to provide any documentation as to how the amount reported had been determined. The Company is referred to SSAP No. 10 which provides guidance for the determination and reporting of deferred taxes.

EDP equipment**Page 31**

The EDP equipment amount reported was decreased by \$76,286 to non-admit non-operating software. Per SSAP No. 16, Paragraph (2), only EDP equipment and operating software are allowable as admitted assets. The Company is directed to ensure that it properly non-admits non-operating software from future Statement filings.

Aggregate reserve for life contracts**Page 32**

The Company failed to include the \$29,135 reserve component for supplemental benefits in its aggregate reserves. The Company should ensure that all components of its reserves are properly included and reported in its aggregate reserves amounts.

Interest maintenance reserve**Page 32**

The interest maintenance reserve was increased by \$74,841 to adjust for the factoring of the current year's realized pre-tax capital gains into the interest maintenance reserve calculation. The Company's Controller initially failed to input the realized capital gains into the Company's investment software system because he did not realize that it was necessary to manually enter these amounts. Therefore, the realized capital gains were not reflected in the amount reported on the June 30, 2005 Quarterly Statement. The Company should ensure that the interest maintenance reserve is properly calculated and reported for future filings.

Asset valuation reserve**Page 32**

The asset valuation reserve was increased by \$72,924. The Company was unable to produce a report from its investment software system to support the initial amount reported on the June 30, 2005 Quarterly Statement. Per the Company Controller, the amount initially reported was incorrect due to errors he made inputting information into the investment software system. A subsequent "corrected" report generated by the Controller after adjusting for these

errors indicated a balance \$10,498 higher than initially reported. In reviewing the “corrected” report, it was noted that bonds were not properly classified on the supporting worksheets, realized capital gains on common stock were not properly included, and real estate had not been adjusted to reflect changes in real estate values as a result of our examination. An additional adjustment of \$62,426 was made to account for these items. The Company should ensure that the asset valuation reserve is properly calculated and reported for future filings.

Dividends to stockholders declared and unpaid**Page 33**

A liability was established for dividends to stockholders declared in June 2005 but not paid until July 1, 2005. The Company has a policy of declaring dividends of \$15 per share at the June and December Board of Directors’ meetings. Although, the Company was unable to provide minutes of the June 2005 Board meeting, it was noted that dividends were paid to shareholders on July 1, 2005. The Company should ensure liabilities are properly accrued.

Subsequent Events**Page 46**

The Company’s consulting actuary is preparing a cash flow analysis based on September 30, 2005 operating results. The CRL actuary has indicated that a substantial increase in reserves may be necessary because the spread between the amount CRL is paying on its annuity products and the amounts it is earning on its investments is not sufficient to cover operating expenses. The Company is directed to ensure the results of the analysis are properly reflected on its December 31, 2005 Annual Statement and in the business plan the Company is preparing. In addition, the Company is directed to provide the analysis to the Missouri Department of Insurance upon its completion.

SUMMARY OF PRIMARY COMMENTS AND/OR RECOMMENDATIONS

Below, the primary recommendations and directives previously made in this report by the Missouri Department of Insurance are reiterated. The Company must ensure that it adequately addresses these areas for its future well being.

- The Board of Directors needs to obtain external representation for professional unbiased input.
- The Board of Directors needs to be active in monitoring and directing Company Operations.
- Management needs to include competent individuals with insurance expertise.
- Excessive expenses, including employee benefits, dividends, bonuses, and salaries should be minimized to reestablish profitable operations.
- Fraud and abuse policy/code of ethics training should be implemented.
- Restitution should be diligently pursued to recover previous misappropriations.
- A comprehensive three year future plan of operation including budgeting and forecasting should be implemented and monitored.

SUBSEQUENT EVENTS

On September 6, 2005, a special meeting of the Board of Directors was held. Per a resolution passed by the directors present, Joseph and Linda Warden were placed on paid suspension.

On September 12, 2005, another special meeting of the Board of Directors was held with all directors in attendance. At this meeting, Joseph Warden was allowed to resign as President of CRL and Linda Warden's employment with CRL was terminated. Jean Warden was appointed to replace Joseph Warden as President.

The Company has begun through its legal counsel to seek restitution from Joseph and Linda Warden for amounts which appear to have been misappropriated and filed suit for damages against Joseph and Linda Warden on October 31, 2005, in Cole County Circuit Court.

The Company's consulting actuary is in the process of preparing a cash flow analysis based on operating results as of September 30, 2005. As of the date of this examination report, the analysis had not been completed. However, the CRL consulting actuary has indicated a substantial adjustment to increase reserves will be necessary because the spread between the amount CRL is paying on its annuity products and the amounts it is earning on its investments is not sufficient to cover operating expenses. At this time, the exact amount of the reserve adjustment is unknown; however, it appears the adjustment will have a material impact on the Company's operations. The Company is directed to ensure the results of the cash flow analysis are properly reflected on the December 31, 2005 Annual Statement and in the business plan the Company is preparing. In addition, the Company is directed to provide the analysis to the Missouri Department of Insurance immediately upon its completion.

ACKNOWLEDGMENT

The assistance and cooperation extended by Capital Reserve Life Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Barbara Bartlett, CPA, CFE, and Andy Balas, CFE examiners for the Missouri Department of Insurance, participated in this examination. Sherri Daniels, FSA, MAAA of the actuarial firm of Milliman USA performed an actuarial analysis as part of this examination.

VERIFICATION

State of Missouri)
) ss
 County of Cole)

I, Mark A. Nance, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.



Mark A. Nance, CFE, CPA
 Examiner-in-Charge
 Missouri Department of Insurance

State of Missouri
 County of Jackson

Sworn to and subscribed before me this 5th day of January 2006.
 My commission expires:

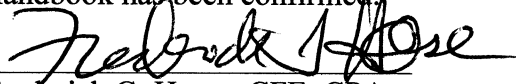
03-17-2008


 Notary Public

BEVERLY M. WEBB
 Notary Public - Notary Seal
 STATE OF MISSOURI
 Clay County
 My Commission Expires March 17, 2008

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with the National Association of Insurance Commissioners procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

A handwritten signature in black ink, appearing to read "Fred G. Heese", written over a horizontal line.

Frederick G. Heese, CFE, CPA

Audit Manager

Missouri Department of Insurance



Capital Reserve Life Insurance Company

812 Madison Street P.O. Box 896 Jefferson City, Missouri 65102 (573) 636-3913

Mr. Kirk Schmidt, CFE, CPA
Chief Financial Examiner
Department of Insurance
P.O. Box 690
Jefferson City, MO 65101

RECEIVED
MO INS DEPT
FEB 21 2006

February 17, 2006

Dear Mr. Schmidt:

Please accept this communication as our *response* to the draft copy of the Examination Report of Capital Reserve Life Insurance Company for the period ending June 30, 2005.

DIVIDENDS:

Capital Reserve's Board of Directors, at a special meeting on October 8, 2005, declared there would be no further dividends paid to our shareholders until the Company returns to profitability.

MANAGEMENT:

Our shareholders have elected four outside directors as of this date. David Warden will remain on the board, has attended all called and regular meetings since the Company's problems surfaced and the questioned fees have been refunded to the Company. However, it should be noted that David Warden had not been notified of meetings held while Joseph E. Warden was serving as President of Capital Reserve Life Insurance Company.

Regarding the lack of participation in Committee meetings by Jean Warden and Frank Warden, we were not given the opportunity to participate in Committee meetings while Joseph Warden was President. Joseph Warden did, upon one occasion, consult with Jean Warden before the purchase of a single bond issue.

CONFLICT OF INTEREST:

The present management will insure that current conflict of interest statements will be secured and kept available.

Joseph E. Warden is no longer serving Capital Reserve Life Insurance Company in any capacity.

CORPORATE RECORDS:

The minutes of past meetings of the Board of Directors have been brought up to date and prior omissions have been corrected.

EMPLOYEE BENEFITS:

All employee benefits, with the exception of health care insurance, have been terminated as of 12/31/2005. The payment of all bonuses has ceased. Frank Warden is again serving as Vice-President in charge of Information Technology at an annual salary of \$50,000.00. Jean P. Warden was elected as President on September 12, 2005 and his annual salary is also \$50,000.00. No vehicles are being used by any Company personnel outside of the sales department. The employees currently assigned Company vehicles are under strict instructions to report any personal use of their vehicles.

There are no employees receiving reimbursement for tuition fees or the cost of textbooks.

TERRITORY AND PLAN OF OPERATIONS:

The Department of Insurance has been furnished with our written business plan as well as our budget and forecast for the next three years. During the tenure of Joseph E. Warden as President, the board of directors was continuously assured that the Company would return to profitability during the following year. None of the Board of Directors, with the exception of Anthony Hutchinson, was allowed access to the corporate accounts and were forbidden to converse with Company employees. That situation has been rectified.

REIMBURSEMENT PAYMENTS TO JOSEPH AND LINDA WARDEN:

A civil suit has been filed against Joseph and Linda Warden subsequent to the Cole County Prosecuting Attorney's refusal to file criminal charges. The Company has also filed claims with the two bonding companies with whom we have coverage. The civil suit is moving along through the normal route to completion.

FRAUD AND ABUSE POLICY/CODE OF ETHICS:

The employees who should have called the ongoing fraud to the attention of the Board of Directors feared dismissal should they reveal the embezzlement that they

became aware of. One must have experienced the wrath of Joseph Warden to appreciate their fear. The remaining staff are fully aware of the degree to which they allowed the reimbursement program to malfunction. Policies are being developed to prevent a recurrence of those mistakes. Removal and termination of the principals involved has been effected, and adequate safeguards have been instituted to insure we will not experience a recurrence of those errors.

BROKER'S AGREEMENTS:

The examination team from the Missouri Department of Insurance were furnished with copies of our current Broker's Agreements prior to their departure. Our Board of Directors approves of the brokers we are currently using.

SECURITIES RATINGS:

At the October 9, 2005 meeting of the board of directors, we resolved to only invest in AAA or AA rated securities, and to dispose of medium and lower quality securities as we are able to do without substantially impairing our surplus. We have utilized these guidelines to the extent possible at the present time.

Ratings of securities held in our portfolio have been adjusted to reflect the current classification furnished by the NAIC VOC.

BONDS:

All short term investments have been properly classified in our recent statement filings.

REAL ESTATE:

The admitted asset value of our real estate has been adjusted to reflect the reductions dictated by the MDI examination team. However, the amount of remodeling costs of \$85,766 that were stated as being unsubstantiated should not have been disallowed, as the documents existed but were not requested from the person who held them in her files.

Depreciation has been adjusted based upon service dates.

DEFERRED TAX ASSET:

The amount of \$18,700 which was previously shown as a deferred tax asset has been removed from the Company's stated assets.

EDP EQUIPMENT:

Non-operating software will no longer be included in the EDP Equipment account.

AGGREGATE RESERVE FOR LIFE CONTRACTS:

Reserves for supplemental benefits are now included in our aggregate reserve amounts.

INTEREST MAINTENANCE RESERVE:

The Company will insure that realized capital gains will be included in future IMR calculations.

ASSET VALUATION RESERVE:

The Company will devote extra care in determining the proper AVR in all future reporting.

DIVIDENDS TO STOCKHOLDERS DECLARED AND UNPAID:

Jefferson City, MO 65101

The minutes of the June 2005 meeting of the Board of Directors are now in place. In the future, extra care will be exercised in reporting accrued liabilities.

SUBSEQUENT EVENTS:

The Company's consulting actuaries have completed their calculation of an asset adequacy reserve which will be furnished to the MDI and included in the liabilities stated in our 2005 Annual Statement.

Our legal counsel continues work on seeking restitution of funds which appear to have been misappropriated by Linda Warden.

Our shareholders have secured the services of four well qualified independent directors.

The problems that our board of directors was previously unable to control have been removed and the resulting difficulties are receiving attention.

Current management has reduced operating expenses by approximately \$1,200,000 annually and is working toward further reductions. The quality of our investment portfolio is being steadily improved; however the improvement in quality is resulting in reduced investment income.

Existing personnel are receiving additional training and are being allowed to utilize their capability to its fullest extent. We believe the quality of the results of their output will be fully acceptable by the Missouri Department of Insurance.

Fraud and abuse of ethics will no longer be a problem at Capital Reserve Life Insurance Company.

A three year plan of operation and budgeting is in place and being implemented.

If additional statements or information is desired, please advise us of our shortcomings and we will make every effort to accommodate your requests.

Sincerely,

A handwritten signature in cursive script that reads "Jean P. Warden". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Jean P. Warden, President
Capital Reserve Life Insurance Company
812 Madison Street
Jefferson City, MO 65101